EFFECTS OF CURTAILING COST-OF-LIVING ADJUSTMENTS
IN SELECTED FEDERAL BENEFIT PROGRAMS

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CONTENTS

Reducing or temporarily forgoing cost-of-living adjustments (COLAs) in federal cash transfer programs could substantially reduce government expenditures by providing lower benefits than would occur under current law. While most of the savings would result from benefit reductions for people who are not now classified as poor--that is, those with incomes above the official poverty thresholds--limiting COLAs would also reduce the incomes of significant numbers of low-income people and would move some of them into poverty. COLA reduction options could be structured to mitigate the impact on low-income people, however, with varying effects on the net budgetary savings.

This paper examines the potential savings and the impact on low-income people of four approaches to curtailing COLAs in cash transfer programs. The first approach would reduce or eliminate COLAs for one or more years for all current recipients under all cash transfer programs. The second alternative would exempt the means-tested programs from COLA reductions. The final two alternatives would provide additional protection for low-income recipients.

While many methods could be used to protect the incomes of the poor and the near-poor, the two examined here would provide COLAs for some Social Security and Railroad Retirement benefits. The "Poverty COLA" approach would increase program payments only if annual benefits based on

a single earnings record were below the poverty threshold, while the "COLA Cap" alternative would grant COLAs on the first $5,000 of annual benefits based on a single earnings record. 1/ Although both options are designed to protect low-income beneficiaries, they would also provide benefit increases to some recipients with total incomes well above the poverty line. Further, these options would be difficult to administer, since they would require that the Social Security Administration provide COLAs to some but not all beneficiaries, or for only part of most recipients' benefits.

Within each approach, four specific options are considered. Benefits could be frozen at current levels for one or three years, or currently legislated COLAs could be reduced by three percentage points, again for one or three years. As one would expect, so long as inflation exceeds 3 percent each year, the benefit freezes would result in larger budgetary savings and greater effects on beneficiaries than the COLA reductions. Also, longer periods of curtailing COLAs would have greater impacts than shorter periods.

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1. Under both the Poverty COLA and COLA Cap options, the benefit measure used to determine eligibility for and size of the COLA would be total benefits--both primary and dependents'--based on a single earnings record; that is, the Social Security/Railroad Retirement record showing the earnings of one worker.

Under both the Poverty COLA and the COLA Cap, some families would be given COLAs on more than the amounts of benefits described above. For example, if both members of a married couple were beneficiaries as a result of their own earnings, under the COLA Cap, the couple could get COLAs on up to $10,000 of annual benefits. On the other hand, a married couple receiving benefits as a worker and dependent spouse (that is, based on the earnings of only one worker) could get a COLA on no more than $5,000 of annual benefits. This approach would be necessary because the Social Security Administration cannot determine whether primary beneficiaries are in the same family.

The Summary Table shows the potential tradeoffs between budgetary savings and effects on low-income program participants for a one-year benefit freeze. For example, a one-year benefit freeze for all non-means-tested cash transfer programs would reduce net federal outlays by $43 billion over the next five years but would also reduce total income to the poor by about $400 million per year and could cause 420,000 additional people to fall into poverty. The Poverty COLA option would generate 25 percent smaller budgetary savings but would have only about one-third the adverse effect on the poor and near-poor. 2/ The COLA Cap approach would protect even more low-income people, but, because it would provide COLAs to many more people with higher incomes, would yield much smaller savings.

The results of this analysis should be viewed with caution for a number of reasons. First, budgetary savings and estimated impacts on poverty statistics are not directly comparable because they are based on different data sources. Second, effects on beneficiaries reflect the population as it was in 1983, not as it will be in the future when COLA changes might be implemented. Third, the Bureau of the Census definition of poverty is used; since the value of in-kind benefits such as food stamps or housing assistance is excluded from income, official poverty statistics may overstate need. Fourth, severe data limitations mean that the beneficiary impact analysis can only be indicative of the actual effects. Other reasons for caution are presented in the text.

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2. Actual increases in poverty gaps and rates would be somewhat smaller than shown here for the Poverty COLA and the COLA Cap. See text for details.

SUMMARY TABLE. ESTIMATED BUDGETARY SAVINGS AND POVERTY EFFECTS OF FREEZING BENEFIT LEVELS FOR ONE YEAR IN SELECTED FEDERAL CASH TRANSFER PROGRAMS

Approach or Programs Affected	Fiscal Years 1986-1990 Budgetary Savings (in billions of dollars)	Change in Poverty Gap a/		Change in Number of Poor People (in thousands)	Change in Poverty Rate (in percentage points)
		(in billions of dollars)	(in percent)		
All Programs b/	45.8	0.6	1.4	530	0.3
Non-Means-Tested Programs b/	42.9	0.4	0.9	420	0.2
Poverty COLA c/	32.9	0.1	0.3	150	0.1
COLA Cap d/	18.6	e/	f/	60	0.1

SOURCE: Congressional Budget Office estimates.

NOTE: Budgetary savings are relative to CBO baseline. Poverty effects are based on tabulations of the March 1984 Current Population Survey which reports incomes for calendar year 1983. See text for additional detail and cautions in interpreting findings.

a.   The "Poverty Gap" is the aggregate amount by which incomes of poor individuals and families fall short of the poverty thresholds, i.e., the total amount of income that poor people as a group would require to move up to the poverty thresholds.

b.   For budget estimates, "All Programs" include Social Security, Railroad Retirement, Civil Service Retirement, Military Retirement, Supplemental Security Income (SSI), Veterans' Pensions and Compensation, and retirement benefits for the Foreign Service, the Public Health Service, and the Coast Guard. For beneficiary effects, only the first five programs were considered. "Non-Means-Tested Programs" include all of the above except SSI and Veterans' Pensions for the budget estimates, but only exclude SSI from the programs examined for the effects on beneficiaries. See text for details.

c.   Full COLA provided for means-tested programs. No COLA provided for non-means-tested programs, except for Social Security and Railroad Retirement benefits on which the full COLA is provided if annual benefits based on a single earnings record are less than the poverty threshold. See text for more detail.

d.   Full COLA provided for means-tested programs. No COLA provided for non-means-tested programs, except for Social Security and Railroad Retirement benefits on which a full COLA is provided on the first $5,000 of annual benefits based on a single earnings record. See text for more detail.

e.   Less than $50 million.

f.   Less than 0.05 percent.

INTRODUCTION

Congressional concern about large and continuing federal budget deficits has led to consideration of proposals to reduce or temporarily forgo cost-of-living adjustments (COLAs) for federal transfer programs. Because these programs account for about one-fourth of all federal spending, they present an opportunity for achieving substantial budgetary savings. Curtailing COLAs is one means of realizing sizable savings while spreading the impact across all current recipients, rather than concentrating effects on only one group. 1/ Nonetheless, limiting COLAs would necessarily affect the well-being of program participants, whose benefits would be lower than under current law. Particular concern has focused on those beneficiaries who are now poor or who might be made poor if scheduled benefit increases did not occur.

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1. While reducing or freezing COLAs for federal cash transfer programs would spread effects broadly among all current recipients, such changes could create inequities between current and future program participants. This would result from the fact that benefit levels in some programs--including Social Security, the largest single transfer program--are based on earnings histories that are indexed for real wage growth. Freezing benefits or reducing COLAs for those now receiving benefits, while not reducing indexing rates for the earnings of today's workers, could result in current retirees getting lower benefits than future retirees, even if their earnings histories were identical in real terms. If the Congress chooses to modify COLAs for those already retired, it could also alter the indexing of benefit formulas to treat current and future retirees more similarly. Making parallel changes in the benefit formulas would also increase budgetary savings and make them permanent. The effects of COLA changes alone would be realized only for as long as current recipients are alive.

This paper examines a number of specific options for curtailing COLAs--some designed specifically to limit the adverse effects on the poor and the near-poor. The first section describes the options considered. The second explains the procedures used to estimate savings and impacts of the options and discusses limitations on the analysis. The final section reports the budgetary savings resulting from COLA changes and the effects of those changes on low-income recipients.

OPTIONS TO CURTAIL COLAS

Currently, nearly a dozen federal cash assistance programs, including Social Security, Supplemental Security Income (SSI), and most retirement programs for federal employees, have legislated COLAs under which benefits are adjusted annually based on changes in the Consumer Price Index (CPI). In addition, although it is not formally indexed, Veterans' Compensation has been increased annually by the Congress in line with CPI changes. 2/ Together, federal outlays for these programs are expected to total $254 billion in fiscal year 1985. Anticipated COLAs will add about $7 billion to fiscal year 1986 spending and will account for $153 billion in additional outlays over the 1986-1990 period.

Numerous approaches are available to limit benefit COLAs. Most broadly, COLAs for all indexed cash assistance programs could be reduced

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2. Other programs are indexed in different ways. Black Lung Disability benefits and Special Benefits for Disabled Miners are increased annually on the basis of changes in the pay of Civil Service GS-2 workers, while food stamps and child nutrition programs are indexed to the CPI for food. None of these programs is considered in this paper.

or eliminated for one or more years. Alternatively, those programs designed to aid low-income people could be exempt, and COLAs could be curtailed only for non-means-tested programs--that is, those programs in which eligibility does not depend on income. Finally, specific COLA-reductions schemes could be created that would protect the benefits of more low-income recipients. This paper considers examples of all three approaches.

Curtailing COLAs in All Cash Transfer Programs

Four options for changing COLAs in all federal cash assistance programs are considered:

o   A one-year reduction in which the COLA is three percentage points less than the increase in the CPI.

o   A one-year freeze on benefit levels in which no COLA is provided.

o   A three-year reduction in which the COLA is three percentage points less than the change in the CPI in each year.

o   A three-year freeze on benefit levels in which no COLA is provided for three years.

This part of the analysis applies the COLA limitations to all federal cash transfer programs legislatively or customarily indexed to the CPI.

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These include Social Security, Railroad Retirement, Military Retirement, Civil Service Retirement, SSI, Veterans' Pensions, Foreign Service Retirement, Public Health Service Retirement, Coast Guard Retirement, and Veterans' Compensation.

Curtailing COLAs Only for Non-Means-Tested Cash Transfer Programs

The second set of options applies the four changes described above only to non-means-tested programs. In these instances, means-tested programs--SSI and Veterans' Pensions--are exempted from the COLA reductions or benefit freezes, but all other programs listed in the preceding paragraph are included. Exempting means-tested programs from any COLA limitations would protect some low-income people from income losses; however, because only a small minority of all poor people receive SSI or Veterans' Pensions, large numbers of poor and near-poor recipients of cash transfers would still be affected adversely by these options.

Further Limiting Effects on Low-Income People

The final two sets of options would go further still in attempting to limit the adverse effects of COLA changes on low-income people. Two specific alternatives are examined to provide contrasting examples:

o   Curtailing COLAs for all non-means-tested programs, except that full COLAs would be provided to Social Security and

Railroad Retirement recipients whose annual benefits (primary plus dependents' based on a single earnings record 3/) are below the poverty line for the number of people receiving primary or dependents' benefits. In other words, a COLA on total Social Security or Railroad Retirement benefits would be paid if benefits are below the poverty threshold. 4/ No COLA would be given to recipients with benefits above the threshold. (This is referred to as the "Poverty COLA" option.)

o   Curtailing COLAs for all non-means-tested programs, except that full COLAs would be provided on the first $5,000 of annual Social Security or Railroad Retirement benefits (primary plus dependents' based on a single earnings record). All Social Security and Railroad Retirement beneficiaries would thus receive some COLA, but those with total annual benefits above $5,000 would receive less than under current law. 5/ (This is referred to as the "COLA Cap" option.)

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3.   That is, the sum of all benefits paid to a worker and his or her dependents based on the Social Security or Railroad Retirement record of that worker's earnings.

4.   To avoid raising benefits of those receiving COLAs above benefits of those not getting COLAs, the COLA is limited to the amount that would be required to raise benefits up to but not over the poverty threshold.

5.   The $5,000 cutoff is defined in 1983 dollars and would be indexed to the Consumer Price Index (CPI) for subsequent years.

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For each of these modifications, the four alternatives listed above--a one-year reduction, a one-year freeze, a three-year reduction, and a three-year freeze--are considered.

Because 85 percent of the elderly poor and about 94 percent of elderly people with incomes between the poverty level and 125 percent of the poverty level receive Social Security or Railroad Retirement benefits, providing COLAs for some Social Security payments would keep many of the poor from becoming even more poor and many of the near-poor from becoming poor. Similarly, since a large majority of younger people who would be affected by curtailing COLAs are Social Security recipients, those near or below the poverty line would also be partially protected by these options. On the other hand, not all poor beneficiaries would be protected, and some of the Social Security and Railroad Retirement COLAs paid under these options would go to people with total income above the poverty thresholds. 6/ Finally, these options would be more difficult to administer, because they would require that the Social Security Administration provide COLAs to some but not all beneficiaries, or for only some share of most recipients' benefits.

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6. The "target efficiency" of these options is discussed at greater length later in the paper.

Numerous assumptions must be made to estimate the budgetary effects of COLA changes and to gauge the impact of such changes on low-income people. Estimating the impact on low-income people, in particular, is subject to a high degree of uncertainty because of data limitations.

Methodology

The starting point for any analysis of this type is a set of assumptions regarding inflation. This analysis is based on the Congressional Budget Office's (CBO's) most recent economic forecast, which projects CPI changes (third quarter over third quarter) of 3.7 percent for 1986, 4.6 percent for 1987, and 4.2 percent for 1988. Applying these assumptions would yield benefit reductions, compared with currently scheduled levels, of between 3 percent for a one-year COLA reduction and 12 percent at the end of a three-year freeze (see Table 1).

Estimating Budgetary Effects. Estimates of the budgetary savings that would result from curtailing COLAs were arrived at in two steps. First, gross benefit payments under the affected programs were estimated by substituting the allowable COLA under each option for the COLA that would be paid under current law. For the first two sets of options, in which all participants in a given program would be treated the same, this simply involved decreasing the currently scheduled COLA by a fixed percentage and

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TABLE 1.   EFFECTS ON BENEFIT LEVELS OF CURTAILING COLAS IN
FEDERAL CASH TRANSFER PROGRAMS a/

Alternative b/	COLA Under Alternative (in percent)	COLA Under Current Law (in percent)	Benefit Under Alternative as a Proportion of Current Law c/
One-year reduction	0.7	3.7	.97
One-year freeze	0.0	3.7	.96
Three-year reduction	3.5	13.0	.92
Three-year freeze	0.0	13.0	.88

SOURCE: Congressional Budget Office.

a.   Assumes 3.7 percent inflation for 1986, 4.6 percent for 1987, and 4.2 percent for 1988 (third quarter over third quarter).

b.   See page 3 for definitions of alternatives.

c.   The proportion is the ratio between what benefit levels would be under the alternative and what they would be under current law, measured at the end of one year for the first two options and at the end of three years for the last two. In the case of the one-year reduction, for example, benefits would be raised 0.7 percent rather than 3.7 percent, so benefits would be 1.007/1.037 = 0.97 as large as under current law.

adjusting for anticipated changes in program participation. For the last two sets of options, in which not all beneficiaries are allowed the same COLA, the process was more complicated. Program data from 1982 describing the distribution of benefits among participants were used to estimate the number of beneficiaries who would be affected and the savings that would result from limiting their COLAs. This process assumed that benefit distributions would be constant over time in real terms. Since the last two sets of options require distributional analyses for which data are incomplete, the results are more uncertain than those for the first two sets.

The second step involved taking account of indirect budgetary effects. Because reductions in income resulting from curtailing COLAs in non-means-tested programs could cause SSI and food stamp benefit levels to rise and could limit some scheduled premium increases for Supplemental Medical Insurance (SMI), initial savings estimates were adjusted to account for these offsetting cost increases. Program data were used to estimate the indirect spending effects. The resulting offsets were subtracted from the direct savings; the savings reported below represent the net budgetary effects that would arise from the various options.

Estimating Effects on Beneficiaries. The impacts of COLA reductions and benefit freezes on beneficiaries were estimated based on the March 1984 Current Population Survey (CPS) which reports incomes for calendar year 1983--the most recent data available. The CPS identifies program benefits under four non-means-tested federal cash assistance programs affected by COLAs--Social Security and Railroad Retirement, Civil Service Retirement, and Military Retirement--as well as under one means-tested, indexed cash assistance program--SSI. 7/ Together these five programs account for about 90 percent of outlays under indexed federal cash transfer programs.

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7. Veterans' Compensation and Pensions, and retirement benefits for the Foreign Service, the Public Health Service, and the Coast Guard cannot be determined from the CPS and are therefore not included in the analysis of impacts on beneficiaries. They are, however, included in estimates of budgetary savings.

In estimating impacts on beneficiaries, income from the programs reported on the CPS that are subject to COLAs was reduced by the factors given in the final column of Table 1 to obtain estimated incomes under the policy alternatives. 8/ The resulting total income for each family was then compared with the 1983 poverty threshold for a family of that type ($4,775 for an aged individual, $6,023 for an aged couple, and $7,938 for a family of three, for example) to calculate resulting poverty rates. In addition, for each option, the effect on the poverty gap--the aggregate amount by which the incomes of the poor fall short of the poverty thresholds--was calculated.

Limitations of the Analysis

The procedure described above provides separate estimates of budgetary savings and impacts on program beneficiaries. Because they are derived from different data sources, the two sets of estimates are not entirely comparable. In addition, the accuracy of the analysis--particularly the estimated impacts on recipients--is limited by:

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8. While the factors given in Table 1 are accurate for people whose benefit levels were determined prior to COLAs being curtailed, they overstate the benefit reduction for recipients who enter affected programs while the changes are in effect. For example, for retirement programs in which benefits are determined by earnings histories, people who become eligible after two years of a three-year benefit freeze are affected only by the final year of the freeze, not by the first two. As a result, the analysis overstates benefit reductions for some program participants. For the options analyzed here, however, only a small minority of all recipients would be affected by this issue, and, therefore, the effect on poverty gaps and rates would likely be quite small.

o   Uncertainty about future inflation rates;

o   Shortcomings of the official poverty measures;

o   An inability to determine in detail the offsetting effects of benefit increases in means-tested programs resulting from COLA cutbacks in other programs;

o   An inability to describe the affected population in 1986; and

o   Problems with the CPS as a source of data.

The results should therefore be viewed with caution and with the following caveats in mind.

Sensitivity of the Analysis to Projected Inflation Rates. The results of this analysis are highly sensitive to assumptions regarding inflation rates. Although this analysis is based on CBO's most recent forecast of inflation rates, those rates are difficult to predict, and actual inflation could be higher or lower than now anticipated.

Budgetary savings and benefit cutbacks under the COLA-reduction options would vary little with different assumed rates of inflation, but the effects of the benefit-freeze options could be significantly less (greater) with lower (higher) inflation rates. To show the effects of a range of CPI increases, the analysis of beneficiary impacts was replicated using constant inflation rates of 3 percent and 6 percent over one- and three-year periods.

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For the two COLA-reduction alternatives, benefits would differ by less than one-half of one percent between these two alternative inflation rates (see Table 2 below). There would be virtually no difference in the effects on official poverty rates (see Appendix Tables A-25 through A-36 for detailed results).

TABLE 2.   PERCENTAGE REDUCTION IN BENEFITS UNDER COLA-LIMITATION OPTIONS RELATIVE TO CURRENT LAW, BY ASSUMED INFLATION RATE a/

Alternative b/	3 Percent Inflation	CBO Economic Assumptions c/	6 Percent Inflation
One-year reduction	2.9	2.9	2.8
One-year freeze	2.9	3.6	5.7
Three-year reduction	8.5	8.4	8.3
Three-year freeze	8.5	11.5	16.0

SOURCE: Congressional Budget Office.

a.   Percentage reductions are calculated at the end of the period during which COLAs would be affected--that is, at the end of one year for the shorter options and after three years for the longer ones. For example, in the case of the one-year reduction with 6 percent inflation, benefits would be raised 3 percent (6-3) rather than 6 percent and would thus be 1.03/1.06 = .972 as large as under current law. The reduction is 1 - .972 = 0.028 or 2.8 percent.

b.   See page 3 for definitions of alternatives.

c.   Assumes 3.7 percent inflation for 1986, 4.6 percent for 1987, and 4.2 percent for 1988 (third quarter over third quarter).

Much larger variation would occur with the options to freeze benefits. Under a one-year freeze, with 3 percent inflation, benefits would be 2.9 percent lower relative to current law, but they would be reduced by nearly twice that if inflation were 6 percent. Under a three-year freeze, benefits would be 8.5 percent lower with inflation at 3 percent, but would be 16 percent lower if inflation averaged 6 percent. Similarly, if inflation is greater than forecast, a benefit freeze would move a larger number of people into poverty.

Limitations of Official Poverty Measures. This analysis uses the official Bureau of the Census definition of poverty, which compares an individual's or family's total cash income with a poverty threshold based on size of family, the age of the family head, and number of children. The individual or family members are classified as poor if income is below the threshold. This definition has numerous well-documented shortcomings. Three problems are particularly significant for this analysis. 9/

First, poverty rates provide less information about the effects of policy options on the poor than do poverty gaps. The poverty rate is affected only when a policy alternative causes incomes to move across the

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9.   Another problem is that poverty statistics make no allowance for geographic differences in living costs. It is more expensive to live in New York City, for example, than in many rural areas, but poverty thresholds are uniform across the country. While data limitations make it impossible to determine the effect of price variations on poverty rates and gaps, it is clear that these thresholds overstate income needs in some locations and understate them in others.

poverty thresholds, even though an option could significantly reduce resources for many individuals and families whose incomes are either well above or far below the thresholds. Changes in the poverty rate, in essence, concentrate attention on the impacts on people in a very narrow band of the income distribution—those just above the poverty thresholds. In contrast, changes in the poverty gap show how policy options would affect the aggregate amount of incomes for people living below the poverty line—a better gauge of the full impact of policy on the poor. Even this measure, however, does not capture the effects on the near-poor who remain above the poverty threshold. Because of time constraints, only changes in poverty rates and poverty gaps are reported below.

A second problem with the official poverty measure is that it omits in-kind income such as food stamps or housing assistance in assessing poverty status, even though such benefits are an important part of the resources available to low-income people. To the extent that in-kind transfers satisfy resource needs and leave cash income available to purchase other things, a family that receives some benefits in kind is less poor than a family with identical cash income that does not have any in-kind income. Excluding in-kind benefits in measuring income thus understates a family's ability to meet its needs and overstates both poverty rates and gaps. 10/

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10. Modifying the current poverty measure is exceedingly complex, how-ever, and alternatives are not considered here. A forthcoming analysis will examine the measurement of poverty in greater detail.

A third problem with the official poverty measure is that by focusing only on cash income, it ignores differences in wealth--that is, tangible assets, such as savings or equity in a home. Wealth is included in the poverty determination only to the extent that it generates cash income, yet the ability to draw down accumulated assets may be an important supplement to current income, especially for the elderly. As a result, assessing whether the elderly are poor by considering only cash income may be particularly misleading.

Offsets Provided Through Means-Tested Transfer Programs. The analysis of impacts on beneficiaries presented here does not fully reflect the effects that constraining COLAs under cash transfer programs would have in expanding eligibility or increasing benefits under means-tested transfer programs, especially SSI, food stamps, and housing assistance. In the case of SSI, benefits are assumed to increase for current recipients to make up for the reduced or forgone COLAs in other programs. 11/ On the other hand, while it is likely that reductions in real income caused by COLA changes in other programs would make more people eligible for SSI (and, as a result, for Medicaid) and would induce some additional eligible people to participate, no additional recipients were assumed in conducting this analysis.

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11. Except under the first approach when the COLA for SSI is curtailed. In that case, the SSI guarantee level--which would decline in real terms--effectively determines recipients' incomes.

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Consequently, estimated changes in poverty rates and gaps are overstated; however, the effect is likely to be modest since new participants would generally only qualify for small amounts of benefits.

Eligibility for and benefit levels in the food stamp and housing assistance programs would also increase if COLAs were reduced in cash transfer programs. For each dollar of cash income lost due to a COLA limitation, a family's food stamp allotment would be increased by 30 cents until the maximum benefit level was reached. Similarly, the rent that a family has to pay for a rent-assisted housing unit would fall by 30 cents for each dollar of lost income. 12/

Because the official poverty measure does not take account of in-kind income, these "offsets" to COLA limitations are not considered in the present analysis. Only a minority of poor households, however, receive these in-kind benefits. In 1982, just 28 percent of poor households with an elderly head and 47 percent of those with younger heads received food

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12. A related effect would occur in the Supplementary Medical Insurance (SMI) component of Medicare, which pays for physician services. Under current law, the annual increase in premiums paid by Medicare beneficiaries for SMI coverage is restricted to the increase in the nominal value of the Social Security cash benefit. Thus, part of the cash income lost by some beneficiaries as the result of COLA restrictions would otherwise have been spent on SMI premiums.

stamps, and only 12 percent of the elderly poor and 14 percent of younger
poor families lived in federally subsidized housing. The low participation
rate for food stamps--an entitlement--reflects, among other factors,
ineligibility because of the asset test and the low level of benefits to which
some nonparticipants are entitled. The low participation rate for housing
assistance reflects the limited availability of subsidized rental units and the
fact that a large share of low-income people own their own homes. 13/

Findings Reflect 1983, Not Future Years. The effects of the COLA options
on beneficiaries have been analyzed for the population as it was in 1983. No
allowance has been made for growth in the population since then, or for
changes in economic circumstances that might affect the poverty rates and
gaps that constitute the starting points for measuring policy impacts.
Improvement in the economy since 1983 is likely to reduce the overall
poverty rate by 1986 as well as the total poverty gap. However, unless the
shape of the income distribution were to change dramatically in those three
years--which is highly unlikely--estimated changes in poverty rates and gaps
resulting from the policy options examined here would be largely unaffected
by the different starting points.

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13. While the number of people participating in food stamps would
    increase slightly if COLAs were curtailed, this effect would be small
    and the average new food stamp benefit would be low. Since housing
    programs are not entitlements, an increase in participation would not
    be possible unless additional units were subsidized.

Data Limitations. Several other data limitations affect the analysis of beneficiary effects, although the resulting bias is likely to be small. First, the analysis is based almost entirely on CPS data, which are subject to underreporting of income. As a result, all poverty rates and gaps may overstate the actual situation. While 98 percent of earnings and 93 percent of Social Security and Railroad Retirement benefits show up in CPS data, only 78 percent of SSI benefits, 61 percent of private pension payments, 57 percent of net rent and royalties, and 43 percent of interest and dividend income are included. 14/ On the other hand, CPS data are used to calculate official poverty measures, and thus the results of this analysis are consistent with published poverty statistics. Moreover, the poor and near-poor are unlikely to have substantial amounts of unreported income from sources such as interest and dividends, though underreporting of SSI presents more of a problem. In any event, while underreporting of income is likely to affect the starting poverty rates and gaps, it is unlikely to have appreciable effects on estimated changes in those measures resulting from the options examined here.

Second, as noted earlier, the indexed federal benefits that cannot be identified on the CPS were necessarily excluded from the distributional analysis. If all indexed cash transfers could have been considered, changes

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14. These values are for 1982. In addition, CPS data may confuse some SSI and Social Security income where surveyed recipients do not know the source of their benefits. This may affect the results of the analysis for all options, but the direction of the effect is uncertain.

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in poverty rates and gaps would be greater than reported below. The effect of the omission is likely to be small, however, because the omitted programs provide less than 10 percent of all benefits subject to COLAs, and because benefits for most participants in the excluded programs exceed the poverty threshold.

Third, state supplements to federal SSI benefit levels are not identified separately on the CPS. Under the SSI program, the federal government pays all benefits up to a level specified in federal legislation, but states may provide supplements, paying the full cost of the additional benefits themselves. (In fact, some beneficiaries receive only the state supplements.) While only the basic benefit level is automatically indexed by federal law, in this analysis COLA options affecting SSI had to be applied to total benefits, the only amount reported on the CPS. As a result, the effects of COLA limitations on SSI recipients may be slightly overstated. Actual effects would depend on how states would alter their SSI supplements if federal benefit COLAs were curtailed.

Fourth, SSI benefits may be understated in the CPS because recent legislative changes had not fully taken effect in 1983. For example, the 7 percent increase in basic SSI benefits that occurred in July 1983 both increased benefits to current participants and probably induced more eligible people to enter the program, but those changes are unlikely to be fully reflected on the March 1984 CPS.

Finally, CPS data make it impossible to model precisely the distributional effects of the final two sets of options--those that would provide COLAs for some, but not all, Social Security and Railroad Retirement benefits. The CPS reports total Social Security/Railroad Retirement benefits for a family; it does not identify primary beneficiaries on whose earnings records benefits are based nor does it identify all dependents on whose behalf benefits are paid. As a result, for the Poverty COLA options, the simulations provided COLAs in two situations: single beneficiaries living alone were given COLAs if their annual Social Security or Railroad Retirement benefits were below the poverty threshold for a single elderly person ($4,775 in 1983), while beneficiaries living in families received COLAs if total annual benefits to the family were less than the poverty threshold for a two-member household headed by an elderly person ($6,023 in 1983). Similarly, under the COLA Cap options, COLAs were assumed to be paid on the first $5,000 of total annual benefits paid to a family, since it was not possible to identify multiple benefits paid to a single family based on separate earnings records. The effects of both these adjustments is to overstate the effects these options would have on poverty statistics.

EFFECTS OF CURTAILING COLAS

The remainder of this paper describes the budgetary savings and potential effects on recipients of 16 specific options for curtailing COLAs in federal cash assistance programs: